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**FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY**

May 31, 1994

Mr. Reed Hundt
Chairman
Federal Communications Commission
1919 M St. NW
Washington, DC 20554

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re: GEN Docket No. 90-314

Dear Chairman Hundt:

I am writing to you concerning recent news reports that the Commission is considering eliminating, or substantially reducing the scope of, the proposed set-aside for small businesses in the upcoming auction of licenses for personal communications services (PCS).

The elimination or reduction in scope of a set-aside of a large block of PCS spectrum will kill the chances that small businesses will have any real opportunity to participate in PCS. Such an act would frustrate the intent of Congress in authorizing the FCC to auction spectrum. Such an act will be anti-competitive. It will result in an even greater concentration of ownership of U.S. communications. It will reduce the potential for meaningful competition in telecommunications and will not lead to affordable wireless communications being available to the American people.

According to news reports, the Commission is concerned that a set-aside could not withstand a challenge to its constitutionality. Instead, it has been reported that a "bidders' credit" will be substituted for a set-aside as the means by which the Commission makes opportunities available to small businesses, including minority and women-owned business and rural telephone companies, as required by Congress.

A bidders' credit is not a substitute for the set-aside. It does not create any opportunity to participate in PCS. In theory, it would reduce the cost of entry for small businesses. In fact, it simply raises the price others will pay. A "bidders' credit" is a red herring. Its real effect will be to kill competition.

We agree that constitutional issues may exist if a set-aside is based on race or gender preferences. However, we believe that no constitutional issues exist if the set-aside is for a class of business, small business, without any race or gender preferences. We believe that there are firm legal and public policy grounds for a licensing structure that includes a set-aside as well as ample opportunity for all others to participate.

Three large blocs of spectrum are going to be auctioned. Two of those three blocs will be available to all businesses, except the local cellular company in each market (and cellular companies can bid for licenses outside their service areas). A set-aside of one of these

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three blocs for small businesses and rural telephone companies should not pose any constitutional problem. A case could be made that the results of an auction without a set-aside will establish good grounds for an antitrust action. A set-aside for a class of business, specifically small business, meets public policy and constitutional tests. It increases the potential of competition, prevents undue concentration of business ownership, does not exclude any company or individual within that class of business from participation and encourages economic growth.

There is also a well-established precedent for a set-aside for a class of companies. One half of all cellular licenses were set aside for one class of businesses, local telephone companies. In PCS, we are only seeking one-third of the major licenses to be set aside. Two-thirds of the major licenses would still be available to the major companies that already control virtually all of the U.S. telecommunications industry. Isn't that enough?

There are long established precedents in broadcast law for limits on concentration of ownership. Why are these precedents not applicable to telecommunications? The number of broadcast licenses that can be owned by one company, in one market, or nationwide, is limited. A set-aside is another form of limitation on the concentration of ownership.

A set-aside for small business would achieve the goal of Congress to make opportunities available to small businesses, including minority and women-owned companies. The act of setting aside one large block of PCS spectrum for small businesses and rural telephone companies, without any gender or racial preferences, in fact creates the opportunity that women and minority-owned businesses need to enter the PCS business. No other preferences are needed because among small businesses there are no inherent inequalities that need to be addressed. By establishing a simple economic test, based on the size of a business, there is no discrimination against any protected class. An equal opportunity for all in that class of business is created. And because most women and minority-owned businesses are small, the public policy interest addressed by Congress of opening up communications to participation by a broader spectrum of our business community is achieved.

Radio spectrum is a publicly-owned limited natural resource. Both the Commission and Congress wrestled with a means by which the public interest could best be served in the awarding of licenses to use public spectrum. The purpose of the auction legislation was not solely to raise revenue for the federal government. A major justification for auctions was to create a rational, and more easily administered, means of awarding licenses to those who really wanted them. Previous efforts with comparative hearings and lotteries had resulted in arbitrary decisions in the case of comparative hearings and enormous speculation in the case of lotteries. Both processes failed to serve the public interest. Both had abuses and often frustrated the Commission and those in the industry who truly wanted to provide service to the public.

The auction process was never intended to result in all licenses going to those companies that could pay the most. In enacting the auction legislation, Congress attempted to place some limits on the concentration of ownership that could result from auctions. Congress told the Commission that if auctions were employed, a means should be adopted to

provide opportunities for new participants. Basically, Congress said that public spectrum should be made available to more of the public.

From the first time PCS was addressed by the Commission, a primary purpose of allocating the spectrum was to increase competition in telecommunications. Ample evidence was cited by the FCC, and many others, that the cellular duopoly had not resulted in effective competition. The General Accounting Office studied the cellular industry and concluded that no meaningful competition exists. Because PCS had the potential of offering competition to both the local telephone company and to cellular, it has been seen as a real opportunity to increase telecommunications competition in the United States. And increasing competition requires more competitors. If PCS is turned over to the companies that already dominate telecommunications, the opportunity to increase competition, and lower costs to the public, will be lost for a generation, at least.

For nearly 100 years it has been the public policy and the law in the United States to control or prevent monopoly concentration of economic power. In telecommunications, the approach was one of control, through regulated monopolies, until the break-up of AT&T. Since then, public policy in telecommunications has shifted to elimination of monopolies through the opening of the business at all levels to competition. The shift of U.S. law and policy has spread rapidly around the world, so today most countries are encouraging new entrants into telecommunications, particularly through the licensing of wireless telecommunications. New telecommunications companies are emerging all over the world and are rapidly advancing the state of the art and are competing successfully against the former monopolies.

With domestic telecommunications revenues approaching \$200 billion, the United States is by far the largest telecommunications market in the world. Yet ownership of telecommunications remains overwhelmingly in the hands of the companies that once formed the Bell System monopoly. Only a handful of large and successful independent companies emerged from the break-up of the Bell System and the enormous growth of telecommunications in the United States during the past ten years.

The concentration of the ownership of telecommunications in the U.S. is staggering. The cellular industry is controlled by the companies that once comprised the Bell System. Six Regional Bell Operating Companies, Air Touch (the wireless spin-off of PacTel), and AT&T, through its pending acquisition of McCaw, control cellular systems serving nearly 70% of the population. Two other major companies, GTE and Sprint, control another 16%. Thus, an oligarchy of 10 companies controls nearly 86% of the cellular industry. Their control is even greater in the largest markets.

Nine of these ten companies control 95% of the cellular licenses and population (POPs) in the 50 Basic Trading Areas (BTAs) that have one million or more people. These 50 BTAs have a total population of 148.4 million people, or 59% of the total population. These nine companies include seven of the eight largest local telephone companies and AT&T.

Without a set-aside, small businesses would be expected to bid against these giants for PCS licenses. Their only weapon would be a "bidders' credit." If they had the high bid, they would only have to pay 75% (or whatever the figure is) of that bid. As the following examples will show, the bidders' credit has no value. All the existing large telecommunications carriers can justify much higher payments for licenses than could an individual entrepreneur, regardless of a bidders' credit.

Let's take a look at what this means in two hypothetical but real-world situations, a comparison between an entrepreneur and first, an RBOC and next, a long distance company.

Market X has a population of 4 million. A prospective PCS business, operated for ten years, has been valued by an entrepreneur, through economic modeling that takes into account the costs of construction and operation, sales and marketing, personnel and turnover of customers, at a net present value of \$320 million. The small business is willing to pay some percentage of that value for the license. What if the company is willing to pay 25% or \$80 million? Knowing that there is a bidding credit of 25%, the company is willing to bid up to \$100 million or so.

The same market is valued by a telephone company, an RBOC, on a much different scale. Many of the construction costs are the same but the RBOC is able to obtain a much better volume discount from the equipment manufacturers with which it already does business. The RBOC can use its existing billing, accounting, order entry and order processing and customer service systems. It can provide existing intelligent network services. It can provide its own telemarketing. It already has management, engineering and operations personnel. It can link that PCS system into a cellular system it owns in a nearby market and market wireless handsets that operate in both frequencies. Thus, it may not choose to operate its PCS system as a full-fledged competitor to both cellular and local telephone service. It may simply be an adjunct to those services.

The RBOC can reduce the costs of construction and operation. It can leverage its existing management, sales and marketing, engineering and operations personnel. It can use its brand name that is already well known in the marketplace. Clearly, its costs of building and operating a PCS system would be less than that of a single PCS entrepreneur. It also has achieved significant strategic advantages by being able to expand the reach of its existing cellular business.

The RBOC has already valued the PCS business on a scale different from the entrepreneur. It can justify paying more for the license simply on this scale. Furthermore, the RBOC can pay for the license from its cash on hand. Is the RBOC going to be deterred by the \$20 million more than market value the entrepreneur is willing to bid? Hardly.

Another example is a long distance company that serves the equivalent of 25 per cent of the people in that market. The average customer bill is \$25 per month. The long distance company is earning \$300 million in revenue from that market each year. Of that \$300 million it is paying approximately \$130 million each year to the local telephone company in access charges. When the long distance company does its financial modeling of that PCS market, it has many of the same advantages of the RBOC. It has network facilities

and services. It has engineering, operations, sales and marketing, management and customer service personnel. It has a brand name. It probably can put a value on that market essentially equal to the RBOC. In addition, it can assume that some percentage of its long distance customers can be persuaded to convert from their local telephone service to the long distance company's PCS service. This will result in reduced access charges. Assume that 25 per cent of the long distance customers make this switch. That will result in a savings of expenses to the long distance company of approximately \$32.5 million per year. Now what is that long distance company willing to pay for that market? The access charge savings alone make the market worth more to the long distance company than it is to the entrepreneur. No bidding credit offsets this advantage.

Similar competitive advantages also exist for local cable television and local ESMR carriers. All the existing carriers have advantages and strategic positions that can justify much higher payments for licenses than could an individual entrepreneur. And all have much more money, in cash, than any entrepreneur.

There simply would be no contest. No entrepreneur will win a bid for any PCS market that is desirable to any of the large companies, regardless of any bidding credit.

In achieving their strategic goals no large telecommunications company is going to allow itself to be shut out of the bidding for PCS licenses it wants by any small business. There are nine large cellular companies, several large cable television firms, three major long distance companies and several other major companies that could bid in the auction and would be willing and capable of outbidding any small business for a specific market. No CEO of one of these large publicly-owned telecommunications company is going to tell his stockholders or board of directors that the company's future potential was put at risk because it didn't outbid a small business for a critical PCS license. No executive heading a PCS organization within a large company is going to report to senior management that he failed to obtain target markets because he was outbid by a small business.

The question may naturally arise how any entrepreneur could compete successfully with these big companies even if there is a set aside? The set-aside creates the opportunity to achieve most of the same economies and advantages that the big companies have. It basically evens out the playing field. It allows new teams into the game. If there is one bloc of frequencies set aside for small businesses, that bloc can be united through a series of business alliances so that nationwide services could be offered. Small businesses could band together to buy equipment at big company volume discounts. Intelligent network services could be shared. A national brand name could be developed.

It is critically important to note that the two national brand names in cellular, "Cellular One" and "Mobilink" exist only because they represent specific blocs of frequencies. And if there is no comparable bloc of frequencies for small business, they will have little chance of developing a brand name to compete with the existing ones.

A set-aside for small businesses of one of the large frequency blocs (30 MHz) is essential to participation by small businesses in PCS. No opportunity for meaningful participation in PCS will be available to small businesses if they are forced to bid against large telecommunications companies for the large frequency blocs, or are relegated to a small bloc of spectrum such as a 10 MHz slice.

A smaller frequency bloc, such as 10 MHz, permanently disadvantages small businesses, virtually ensuring their failure in the wireless communications business if they are able to raise any capital to obtain a license. Venture capitalists have little or no interest in backing ventures in 10 MHz bands.

If there is no set-aside of one of the large spectrum blocs for small businesses, there will be little or no effective participation by small business in PCS.

You have said that two of your goals in PCS are to spur economic growth and to provide wider access to telecommunications by those who have not been able to participate in the past to any significant extent. In addition, and consistent with your goals, the Commission has consistently expressed an intent to create more competition in wireless communications.

Substantial participation by small businesses in PCS is likely to provide the nation with far greater economic growth than if PCS is developed almost entirely by the existing large telecommunications companies. Small businesses that build PCS systems will become large businesses. They will buy more equipment, more computers, more network facilities than will the large companies that already have network infrastructures. Small businesses will create many more jobs than would existing telephone, cellular or long distance companies. The existing companies have organizations in place ready to support PCS. Small businesses are likely to provide a greater employment opportunity in telecommunications for minorities and are likely to create more good jobs where they are needed most.

The existence of a set-aside is critical to the investors who are interested in supporting small businesses. Without a set-aside the amount of venture capital available to small businesses to bid for licenses and to build systems is likely to be minimal. Even debt-financing may be much more expensive because of the higher risk factors that will be assigned to a small business.

If there is no set-aside, PCS will have been turned over to the large telecommunications companies. Many of the companies which will benefit are the same companies that dominate cellular. The public interest will not be served. This certainly will not create more competition. What incentive will exist for reducing costs or accelerating PCS development? Without the real threat of serious competition from a bloc of small businesses the existing industry will have less of an incentive to be competitive. If dominated by telephone and cellular companies, PCS will be deployed at a more leisurely pace and more as an adjunct to cellular and local telephone service than as a full-fledged competitor.

PCS can be the most dynamic business in the nation in the second half of this decade and well into the next century. But for the nation to gain the maximum value from PCS, there must be an influx of new entrants and new ideas into telecommunications. The oligarchy of major companies that controls 85% of the existing cellular business cannot be permitted to obtain 100% of PCS as well. Even two-thirds seems excessive.

A strong alliance of small business PCS companies and rural telephone companies could provide powerful competition to the existing large companies and ensure that PCS realizes its promise. Such an alliance is a likely occurrence if there is an identifiable large bloc of spectrum and if there is a set-aside.

I cannot emphasize strongly enough how important the set-aside is to small business participation in PCS, to the stimulation of economic and technological growth of the U.S., and to providing an opportunity for broader access to telecommunications by more American citizens.

Very truly yours,

Daniel C. Riker

cc:

Commissioner Andrew C. Barrett
Commissioner James H. Quello
Commissioner Rachelle Chong
Commissioner Susan Ness
Karen Brinkmann